

CHAPTER 11

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11-000 Audit Of Contractor Compliance With Contract Financial Management Requirements**11-001 Scope of Chapter**

This chapter provides guidance that is peculiar or special to the accomplishment of the audit of contractor compliance with contract financial management require-

ments. To the extent appropriate under the circumstances, Chapters 3, 4, 5, and 6 of this manual are equally applicable to the audit assignments discussed in this chapter.

11-100 Section 1 --- Audit of Contractor Compliance with "Limitation of Cost," "Limitation of Funds," and "Limitation on Payments" Clauses**11-101 Introduction**

This section provides guidance for auditing contractual limitations on costs, funds, and payments.

11-102 General

Contract limitation of cost clauses (FAR 52.232-20 and 21) and limitation of funds clause (FAR 52.232-22) contain financial reporting requirements for cost-type contracts. The contract limitation on payments clauses (FAR 52.216-5, 6, 16, and 17) contain financial reporting requirements for contracts with price redetermination provisions and fixed-price incentive contracts. The limitation of cost and funds clauses in cost-type contracts require the contractor to advise the contracting officer in writing whenever the contractor has reason to believe that costs expected to be incurred under the contract in the next 60 days (may vary between 30 and 90 days) when added to all costs previously incurred, will exceed 75 percent (may vary between 75 and 85 percent) of the estimated total contract costs or funds allotted to the contract, respectively. The limitation of cost clause also requires the contractor to notify the contracting officer when there are indications that the total cost for the performance of a contract will be substantially greater or less than the estimated total contract cost. Under FAR 52.232-20, 52.232-21, and 52.232-22, the government is not obligated to reimburse the contractor for costs incurred in excess of cost or funding limitations. Simi-

larly, the contractor is not obligated to continue performance under the contract or otherwise incur costs in excess of the limitation or, if the contract is cost sharing, the amount then allotted by the government to the contract plus the contractor's corresponding share. However, if the government notifies the contractor in writing that the amount allotted to the contract has been increased and specifies the amount, the government is then obligated to the total revised amount allotted to the contract. The limitation on payments clause in contracts with price redetermination provisions and fixed-price incentive contracts requires the contractor to report to the contracting officer the costs in relation to billing prices on items for which final prices have not been established. The objective of Limitation on Payments Statement quarterly submissions is to keep billing rates during contract performance in line with expected final prices; indicated overpayments can be recouped and excessive billing rates adjusted on a timely basis. This is a minimum requirement. The contract or the procuring agency may require additional reporting, or the contractor may prepare other internal reports in addition to those required by the government.

11-103 Scope of Audit

Knowing the management tools available to a contractor in controlling, projecting and monitoring contract costs is of utmost importance. Obtaining this knowledge is an integral part of system audits aimed at determining the adequacy

of contractor financial management systems. It is important for the auditor to ascertain that the contractor has the financial management tools necessary to adequately identify potential contract overruns or underruns. The auditor should promptly notify the contractor and the ACO of any deficiencies. In evaluating the contractor's financial management policies and procedures, the auditor should ascertain:

a. The nature and adequacy of controls which govern the establishment of budgets; the procedures for accumulating incurred costs by budget element; the actual cost compared to budgeted costs; the means provided for comparing incurred costs to the percentage of contract completion; and development of estimates to complete (ETC).

b. Whether the contractor's organization effectively utilizes its financial management tools to promptly report potential cost overruns and underruns to contractor management and subsequently to the government.

c. The methods by which the overall contract financial controls relate to the day-to-day supervisory controls maintained at the operational level.

11-104 Audit Procedures

The audit procedures suggested in this section are not intended to be all-inclusive; the auditor, after considering these guidelines, must develop an audit program based on individual circumstances. At the beginning of the audit the auditor should coordinate with the cognizant contracting officer as discussed in 4-103.

11-104.1 Determination of Reporting Requirements

When appropriate, the auditor should:

a. Determine, from contract briefing files or other available sources, those contracts which require limitation of cost reports, limitation of funds reports, or limitation on payments statements.

b. Ascertain whether the contractor is required to meet additional reporting requirements not specifically required by the contract.

c. Ascertain whether internal reports, in addition to those required by the contract, are prepared to increase internal financial

management controls. If so, they should be compared with the reports submitted under the contract to determine whether significant differences exist.

d. Compare the reporting requirements among various contracts and determine whether there is duplication in the reports required and in the information assembled. The auditor should consider the possibility of the contractor using reports required by one military department, command, or Service to satisfy the needs of all contracting officers.

11-104.2 Evaluation of Reporting Controls

When appropriate, the auditor should:

a. Evaluate the contractor's procedures applicable to the budgetary controls of individual contracts and compare the estimated cost of individual tasks and departments in the cost estimate with the budgeted funds.

b. Ascertain and evaluate for each division (or plant) the internal procedures for controlling the financial status of government contracts and determine the source of the reported incurred costs and the basis for ETC. The auditor also should determine the extent and frequency of supervisory reviews of the status reports and whether explanations are required when there are significant deviations from the budget.

c. Ascertain and evaluate the manner in which revised ETC, in terms of engineering and production manhours, relate to the production control schedules and engineering manpower schedules at specific work centers.

d. Evaluate the documentation flow of the financial status reports from the various sources to the finance manager responsible for preparing the overall financial report for the assigned project.

e. Evaluate the controls exercised by the finance manager, including:

(1) the manner in which the source data are reviewed for reliability,

(2) the basis for changes to the source data, and

(3) a determination of the extent to which requests for explanations from operations responsible for the source data are

made relative to causes of potential cost overruns or underruns.

11-104.3 Audit Objectives

The audit objectives are (1) to determine whether the contractor has complied with the reporting requirements contained in the contract clause and (2) whether the financial data contained in the contractor's reports and statements are reasonable and consistent with the data presented in other required government reports and/or claims.

11-104.4 Audit Guidelines

The audit guidelines which are applicable to the minimum reporting requirements in 11-102 are as follows:

a. Ascertain whether the contractor is submitting reports required by its contracts. Compare these reports with the contractor's internal financial reports for consistency.

b. Evaluate limitation of cost reports. The limitation of cost clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of, or will be greater or substantially less than, the estimated cost specified in the contract. The contractor must submit a revised estimate of the total cost of performing the contract as part of the notification. Limitation of cost reports should be evaluated using the following guidance:

(1) Evaluate the contractor's revised EAC using the guidance in 14-205f.

(2) Ascertain whether the limitation of cost reports in successive periods reflect significant cost overruns or underruns.

(3) Ascertain whether the contracting officer has obtained contractor explanations for overruns when continuous overruns have occurred over an extended period.

(4) When continuous underruns are projected over an extended period, and when the overall estimated contract price has not been reduced, the auditor should ask the contracting officer why.

(5) When individual contracts indicate continuous significant cost overruns or underruns, the auditor should evaluate this

condition in relation to the price established at the time of award. If it is determined that consistent overruns or underruns resulted from defective initial pricing, the contracting officer should be so advised.

c. Evaluate limitation of funds reports. The limitation of funds clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of the funds currently allotted or, for cost sharing contracts, this amount plus the contractor's corresponding share. This notice must include an estimate of the amount of additional funds required to continue performance for the period specified in the contract. Limitation of funds reports should be evaluated using the guidance in 11-104.4b above.

d. Evaluate limitation on payments statements. Limitation on payments (LOP) statements must be submitted quarterly, in accordance with the provisions of FAR 52.216-5, 6, 16, or 17. The primary objectives of LOP statements are to provide for recoupment of overpayments and to indicate a need for a reduction in billing prices. These conditions become apparent when the contractor is underrunning targets used to establish billing prices. Overruns are indicated when estimated final prices exceed invoice amounts. This indicates possible need for increased billing prices and/or revision of liquidation rates. The general objective is to keep billing prices in line with expected final prices during contract performance. Progress payments and LOP statements should be evaluated at the same time. Even though a request for audit may specify a particular document, auditors should try to identify both submissions with comparable cutoff dates for direct comparison and reconciliation. Evaluate LOP statements and reconcile them to progress payment requests using the following guidance:

(1) The auditor should determine that costs related to delivered items are the same as the amounts excluded from costs shown as a basis for unliquidated progress payments (Item 20a of the progress payment request).

(2) The price of items invoiced should be the same as Item 21a on the progress payment request when both submissions have the same cutoff date.

(3) The EACs used to prepare LOP statements and progress payment requests should be the same. The most current estimates should always be used. EACs should be evaluated using the guidance in CAM 14-205f.

(4) The auditor should assure the comparability of contract items used in computations required by the various subsections of the Limitation of Payments Statement. In all instances, cost data should relate to supplies and services delivered and accepted.

(5) The auditor should determine the methods used by the contractor to identify actual costs of delivered and invoiced items. Understatement of this amount usually results in an overpayment of progress payments by overstating the costs eligible for progress payments applicable to undelivered and uninvoiced items.

(6) The auditor should ascertain whether the contractor makes prompt refunds or adjustments when cost underruns

are indicated in the performance of fixed-price redeterminable contracts.

11-104.5 CAS Compliance

The auditor should determine if reporting practices comply with CAS 401, "Consistency in Estimating, Accumulating, and Reporting" (See Chapter 8).

11-105 Reports

Reports will be furnished in response to specific requests for evaluations in this area. Audit reports will be prepared in accordance with 10-1200. When there is reason to recommend correction of a substantial deficiency, a special report will promptly be initiated by the auditor even if there is no request from a contracting officer. Other deficiencies may be included in periodic reports on the overall system of accounting and internal control.

11-200 Section 2 --- Audit of Contractor Compliance with Earned Value Management System (EVMS) Guidelines

11-201 Introduction

This section provides guidance for auditing contractor management systems on selected weapons systems contracts. Also, as appropriate, see the guidance in 9-1300 regarding joint team reviews. The mandatory guidelines that must be met by the contractor are prescribed in DoD 5000.2-R.

11-202 Performance Measurement

11-202.1 Introduction

a. In December 1996, the Under Secretary of Defense (Acquisition and Technology) accepted Industry Guidelines for Earned Value Management (EVM) replacing the DoD Cost/Schedule Control System Criteria (C/SCSC). The implementation of EVMS guidelines for DoD contracts is contained at DFARS 234.005-70, 252.234-7000 and 252.234-7001. DoD 5000.2-R, Subpart C2.9.3.4 Integrated Contract Performance Management and Appendix VI, Earned Value Management System Guidelines were revised to reflect the mandatory EVM guidelines for a contractor's management system to effectively manage selected weapons systems contracts. The guidelines represent the framework for an integrated management system that provides for (1) planning the timely performance of work, (2) budgeting resources, (3) accounting for costs and measuring actual performance against plans, and (4) replanning resources needed to complete the contract when significant deviations from plans are identified. A contractor's management system must meet 32 guidelines organized into the following five major categories: Organization; Planning, Scheduling and Budgeting; Accounting Considerations; Analysis and Management Reports; and Revisions and Data Maintenance. Detailed uniform guidance for implementing the guidelines and conducting systems audits is provided in the Earned Value Management Implementation Guide (EVMIG) (DCAA reference DCAAP 7641.47). The EVMIG may be

found on the DoD Legacy Deskbook as a Discretionary DoD Document. DoD 5000.2-R may be found on the Legacy Deskbook as a Mandatory DoD Document.

b. The referenced DoD Regulation provisions are applicable to contractors with estimated research, development, test and evaluation (RDT&E) contracts, subcontracts, other transactions agreements, and intra-government work agreements with a value of \$73 million or more or procurement contracts with a value of \$315 million or more (in fiscal year 2000 constant dollars). Firm-fixed-price contracts (including fixed-price contracts with economic price adjustment provisions), time-and-materials contracts, and contracts which consist mostly of level-of-effort work are excluded. Exceptions may be made for individual contracts. In any event, the auditor must refer to the specific terms of the contract to determine whether the contract contains reporting requirements for EVMS guidelines. General responsibilities of the auditor during EVMS implementation and surveillance are delineated in the Earned Value Management Implementation Guide (EVMIG), which supplements and elaborates on the provisions of the DoD Regulation.

c. The Defense Contract Management Agency (DCMA) is the DoD Executive Agent responsible for the implementation of EVMS on DoD contracts. DoD components are required to implement earned value effectively and designate to DCMA an EVMS focal point.

d. Since DoD's C/SCSC guidelines, contractors' previously approved cost/schedule control systems are considered to be acceptable under the EVMS guidelines. Thus, DoD encourages contractors whose operating management systems have been accepted as compliant with C/SCSC to implement the Block Changes procedures to change all existing contracts with C/SCSC requirements within their facilities to a single EVMS business process. Accordingly, contractors with acceptable cost/schedule control systems under C/SCSC are not required to demonstrate

that their management systems meet the EVMS guidelines and are not subject to the initial compliance audit procedures outlined in 11-202.3.

11-202.2 Integrated Baseline Reviews

The Integrated Baseline Review (IBR) is a formal audit conducted by the government following contract award to verify the technical content of the Performance Measurement Baseline (PMB) and the accuracy of the related resources (budgets) and schedules. The IBR will be conducted within 6 months of contract award. An IBR will also be conducted when work on a production option of a development contract begins or, at the discretion of the program manager, when a major modification to an existing contract significantly changes the existing PMB. The IBR is a streamlined approach to assessing the PMB on new contracts. The IBR is conducted under the assumption that the contractor is using an accepted EVMS internally for program management and that there is a thorough and effective government surveillance program ongoing at the contractor's facility. This audit therefore is not as comprehensive as the initial compliance and post-acceptance audits of contractors' EVMSs. Accordingly, audit assistance will not usually be requested. However, when any part of the system is not clearly understood, the assistance of the auditor may be desired. If the assistance of the auditor is needed, the program manager will notify the cognizant auditor as soon as possible. The auditor will be responsive to the program manager for evaluation of those accounting and/or financial aspects of the contractor's system.

11-202.3 Initial Compliance Audits

a. DFARS 252.234-7001, Earned Value Management System, requires the contractor to be prepared to demonstrate that its management system complies with the EVMS guidelines as required by DoD 5000.2-R. Contractors whose EVMS were accepted for application to another contract of the same type (e.g., development or production) at the same facility will not be required to undergo an initial compliance

audit. The initial compliance audit is conducted by a DoD team whose leader is appointed by DCMA. The team includes a DCAA auditor. Team members should be advised of the estimated audit starting date in advance and furnished information about the contractor's EVMS.

b. The team will make a Progress Assistance Visit (PAV) to the contractor's facility, normally within 30 days after contract award, to conduct an initial audit of the EVMS description. The contractor will usually make presentations on the EVMS's design and operation and explain applicable reports. The team will examine selected documents and procedures proposed by the contractor and a schedule will be developed for future visits to conduct the IBR and the initial compliance audit. Areas of noncompliance and potential problems will be identified. Recommendations for systems improvements should be forwarded to the team leader for evaluation and discussion with the contractor. The contractor will be given an opportunity to correct noted deficiencies.

c. The EVMS initial audit should begin as soon as practicable following completion of the PAV and implementation of the EVMS. The contractor will demonstrate to the team how the EVMS is structured and used in actual operation. The contractor shall provide the team with a written description of the EVMS. The review team will examine contractor records and information to ascertain compliance with the EVMS guidelines and document its findings.

d. After the demonstration review, the team will conduct the initial compliance audit using the system characteristics contained in EVMS Evaluation Guide, Appendix B of the EVMIG. During the initial compliance audit, the contractor will provide an overview briefing to familiarize the team with the proposed EVMS and identify any changes to the EVMS since the most recent PAV. If necessary, the team will evaluate any changes to the PMB since the most recent IBR. The team will evaluate, on a sampling basis, the reporting of cost and schedule performance against the baseline plan to verify the adequacy of contractor controls and accuracy of management reporting information. The team may con-

duct interviews of selected contractor personnel to verify that the EVMS is fully implemented and being used in the management of the contract. A report will be issued 30 days after completion of the audit and approval of all significant contractor corrective actions, if necessary.

e. A system for controlling development effort is generally different from a system for controlling production work; accordingly, separate initial compliance audits may be required for each although only one program may be involved. Simultaneous audits of the EVMS used for development and production may be performed. This eliminates the necessity for multiple audits. In addition, the contractor may implement one system for both types (development and production) of contracts. When the contractor implements one system for both types of contracts, the system to gain acceptance must clearly demonstrate that it meets the guidelines applicable to production type contracts, i. e., the system can demonstrate that it meets the guidelines for production contracts in the way work is planned and controlled and the way costs are collected and analyzed. The focus of the compliance audit will be determined by the extent and nature of the production effort in the contract.

f. After the successful completion of an initial compliance audit, an advance agreement between the government and the contractor is executed which specifies that the contractor will maintain and use the accepted EVMS as an integral management process on the current as well as future contracts. The agreement should be incorporated into each contract requiring the application of the EVMS guidelines. The agreement is signed by the ACO and a contractor representative at the commensurate level, e.g., the division manager may sign the agreement when the EVMS is used throughout the corporation's division. In addition, a Memorandum of Agreement (MOA) may be executed between the Program Management Office (PMO) and the Contract Management Office (CMO). The MOA identifies key government EVMS individuals and establishes the working relationships between the PMO and CMO. Auditors normally should not be requested

to sign advance agreements or MOAs. The auditing standard of independence precludes DCAA from entering into most agreements. Auditors may communicate in writing by a memorandum to the CMO the auditor's expected role in the EVMS surveillance process. If the CMO insists on the FAO entering into an advance agreement or MOA, the FAO should send the proposed agreement or MOA and background material through the regional office to Headquarters, ATTN: P for coordination before executing the agreement or MOA.

11-202.4 Post Acceptance Audits for Cause

After the initial acceptance of a contractor's EVMS, no further audits for system acceptance will be conducted unless there is a specific need determined by the government. A post acceptance audit may occur when conditions warrant, e.g., solving a major system application problem identified by the program manager or a surveillance monitor. The scope and conduct of the audit will focus on the system processes affected by the problem. The audit will be scheduled based on written government notification to the contractor. The review team director will be selected by the CMO EVMS monitor and the review team will be composed of the appropriate EVMS government surveillance personnel needed to address the identified problem. The review is similar to an initial compliance audit and the EVMS Evaluation Guide should be used when compliance with specific guidelines is required. The review director will issue a report within 30 days after completion and approval of all significant contractor corrective actions.

11-202.5 Surveillance Audits

Immediately following demonstration and acceptance of the contractor's management control system, surveillance by DCAA and the Contract Management Office (CMO) will be performed to ensure that the contractor's system continues to comply with the EVMS guidelines and produces valid and timely data. Surveillance is also performed to ensure that any proposed or actual changes to the EVMS

comply with the guidelines and are reflected in the contractor's system description. Surveillance will provide for verifying, tracing, and evaluating the information contained in the reports submitted to DoD procuring components. In the event deficiencies are disclosed, or if there is an indication of an adverse effect on contract performance because of such deficiencies, the CMO EVMS monitor and the contractor should be promptly informed.

11-203 Audit Objectives, Scope, and Procedures during Integrated Baseline Audits, Initial Compliance Audits (System Implementation Audits), and Post Acceptance Audits for Cause

Upon receipt of a specific request, the applicable FAO will assign an auditor to be a member of the IBR, initial compliance audit or post acceptance audit for cause team. Auditors assigned to these teams should be familiar with the EVMIG (EVM Implementation Guide, DCAAP 7641.47) and have some training in EVMS guidelines. Prior to the audit, auditors should become thoroughly familiar with the contractor's EVMS by reviewing the contractor's system description and analyzing cost management reports (11-300) for the contract under audit.

11-203.1 Audit Objectives

The auditor's primary objective is to audit the accounting system and related financial areas to determine whether the management control system complies with the EVMS guidelines on areas assigned and is being implemented on the contract under audit. The auditor is responsible for advising the team chief, on the areas audited, of the conclusions and will be responsible to the team chief for the timely completion of the effort specifically assigned. As members of an EVMS guidelines review team, auditors may be involved in cost account/functional manager interviews, questionnaire completion, discrepancy report preparation, documentation audits, and audit report preparation. Auditors should perform as much preliminary work as possible in advance of the team visit in order to provide conclusions on any

EVMS deficiencies to the team chief by the end of the EVMS guidelines audit.

11-203.2 Scope of Audit

a. The DCAA team member is responsible for the preparation and execution of a detailed audit program for all areas assigned by the team chief. Technical direction will be provided by an audit supervisor. Auditors should also assess whether deficiencies disclosed in reports on MMAS, labor, other accounting systems, forward pricing rates, budgets, and billing systems are likely to affect the contractor's EVMS. If the contractor has other contracts requiring an approved EVMS, the auditor should also determine if deficiencies being reported in EVMS surveillance reports (11-204) have an impact on the contract under audit.

b. The auditor is responsible for advising the team chief, on areas audited, whether the management system meets the requirements of the EVMS guidelines. Unresolved disagreements should be referred to the regional office and, when necessary, to DCAA Headquarters, ATTN: P. The report should be qualified and should recommend that the system not be accepted when (1) unacceptable accounting policies or practices have a substantial impact on system operation or output, and/or (2) access to budgetary data or operating forecasts necessary for system validation is lacking. Additional guidance on access to data is provided in paragraph e. below.

c. If the auditor becomes aware of significant accounting or financial aspects of the contractor's EVMS that have been omitted from the IBR, initial compliance audit, or post acceptance audit for cause and an inadequate system may thus be accepted, the circumstances should be immediately brought to the attention of the team chief and documented in the DCAA files. Comments on these matters should also be included in the audit report together with statements regarding their expected impact on the system and related reporting of contract performance.

d. An EVMS is intended for contractor use in managing contracts and for government use in monitoring contract perform-

ance. Application of the provisions of DoD 5000.2-R should not result in the development or use of two systems, one for the contractor's internal use and the second merely to satisfy the intent of the guidelines. Evidence of intended or actual parallel operation should be fully evaluated and the results discussed with other members of the EVMS guidelines review team. A determination that only one system will be used is necessary prior to acceptance of the proposed EVMS.

e. Unrestricted access to all data affecting contract costs, both direct and indirect, including budgets and operating forecasts, is necessary to properly audit an EVMS. If the contractor refuses access to required data, the auditor will advise the team chief and the CMO EVMS monitor and enlist their aid in obtaining the information. If the contractor continues to deny access, the auditor will recommend, in writing, that the system not be accepted. In the event that access to required data is made available during the audit but the auditor has been formally advised by an authorized representative of the contractor that the data will be withheld during the surveillance process, a comment to that effect will be included in the audit report, together with a statement that lack of access to data may result in qualification of system surveillance audit reports.

f. In addition to serving as an EVMS guidelines review team member, auditors are responsible for monitoring contractor corrective action in assigned areas. If the contractor fails to take effective corrective action or fails to make acceptable progress in resolving deficiencies, contractual remedies should be recommended (e.g., withhold progress payments, disallow costs).

g. In those cases when management control acceptance is delayed for an extended period of time after contract award because the system has not been fully accepted or has been found to be unacceptable, DCAA surveillance activities should concentrate on verification of reported data and consistency between cost and schedule information and information from other contractor systems.

11-203.3 Audit Procedures

a. Select those tests and other auditing procedures that are necessary to adequately complete the work assigned. These procedures will include tests to verify that the management control system meets the guidelines for the areas assigned. Make maximum use of prior audits and knowledge accumulated by the resident audit staff so as to avoid duplication of effort. However, auditors should conduct sufficient tests of the assigned guidelines during each EVMS guidelines review to confirm that the management control system has in fact been implemented on the contract being audited.

b. In evaluating whether a contractor's management control system complies with the guidelines, the auditor should conduct audit procedures similar to those performed during surveillance of the EVMS guidelines (11-204). Guidelines which DCAA is commonly asked to evaluate include: Organization Guideline 4, Planning, Scheduling and Budgeting Guideline 8, 9, and 13 all of the Accounting Considerations Guidelines, and Analysis and Management Reports Guidelines 22, 24 and 27 and Revisions and Data Maintenance Guideline 30 (See Part I, Section 2 of the EVMIG for a narrative description of each EVMS guideline). The team members should use the EVMS Evaluation Guide, Appendix B of the EVMIG (DCAAP 7641.47), as necessary in the examination of contractor management control systems to ensure compliance with the guidelines. The EVMS Evaluation Guide includes a restatement of guidelines followed by the related system characteristics expected to be part of an acceptable EVMS. Auditors will need to design specific audit steps to verify that the expected system characteristics are present in the contractor's EVMS.

c. The auditor's supervisor will provide technical direction to assure the proficiency of the work performed. All work will be reviewed by the supervisor prior to forwarding reports or conclusions to the team chief.

11-204 Audit Objectives and Procedures for Surveillance Audits

a. Basic auditor responsibilities during surveillance audits are summarized in Part II, Section 3-2a(3) of the EVMIG; more specific audit guidance is provided in subsequent paragraphs.

b. A written description of the acceptable EVMS should be furnished to the auditor by the CMO EVMS monitor. The description should be included in the permanent files and used for planning the surveillance audit program.

c. Periodic audits should be made of the contractor's performance measurement policies, procedures, and practices to determine whether the contractor is continuing to operate the system as originally accepted by the review team, subject to any authorized or other contractual changes. The frequency and scope of audit should be predicated on:

(1) the adequacy of accounting procedures and controls and the effectiveness with which they are implemented,

(2) the quality of available evidential matter,

(3) the results of prior surveillance audits,

(4) the extent of internal audits performed in the EVMS guidelines area, and

(5) deficiencies noted in other contractor systems, such as billing, budgeting, compensation, IT, estimating, general accounting, indirect and other direct cost accounting, labor cost accounting, material management and accounting, and purchasing. Audits should be performed at least once a year, although tests of certain aspects of the system (i.e., evaluation of variance analyses, data reconciliations, system integrity, and estimates to complete) should be performed as frequently as necessary to ensure continued reliance on the system and related output.

d. To the extent possible, surveillance efforts should be integrated with the evaluation of other areas such as the estimating system, billing system, budget preparation, production scheduling and control, and other related contract financial management functions. To ensure adequate evaluation of the system and related output, and to preclude any

duplication of effort, programmed surveillance should be coordinated with the CMO EVMS monitor. This coordination should include a discussion of those aspects of the system scheduled for audit as contained in the FAO's annual plan. The program monitor should also be advised of other evaluations scheduled that may relate directly or indirectly to the EVMS. Formal agreement for surveillance activity should not be affected since the degree of surveillance required may vary considerably between contracts and from one period of contract performance to another. Actual and proposed changes to any facet of the contractor's financial management system (budgeting, accounting, or reporting) should be evaluated in terms of their effect on the accepted EVMS. Existing or potential problems created by these changes should be discussed with the contractor and the resident ACO/government monitor to ensure prompt and correct resolution.

f. DoD 5000.2-R, Subpart 7.15.7.2, Cost Performance Report, establishes the Cost Performance Report (CPR) as the primary reporting format for performance measurement of major defense systems. As part of the audit required in 11-204c., the auditor will selectively test the accuracy and reliability of data contained in the CPRs generated by the contractor's EVMS and ensure that similar data presented in other reports, such as Contract Funds Status Reports (CFSRs) and Contract Cost Data Reports (CCDRs) for the same periods, are reconcilable to the data contained in the CPR. The CPR is discussed further in 11-304.

g. As a minimum, the procedures contained herein will be considered in developing an audit plan for an EVMS audit. The plan should be related to programs developed for evaluation of other areas to minimize the possibility of duplication of effort. Further, it is of paramount importance that the auditor be continuously alert to the fact that one of the basic objectives of a performance measurement system is to provide early disclosure of existing or potential cost growth conditions. Accordingly, particular emphasis should be placed on the

areas of control for contract changes, variance analyses, and evaluations of estimates to complete.

11-205 Verification of Budgeted Cost for Work Scheduled (BCWS), Budgeted Cost for Work Performed (BCWP), and Actual Cost for Work Performed (ACWP)

The Performance Measurement Baseline is the time-phased budget plan against which contract performance is measured. It is formed by the budgets assigned to scheduled cost accounts and the applicable indirect budgets, which may also be known as the scheduled direct costs and applicable expense rates, and is sufficiently detailed to the work package level to ensure adequate performance measurement. The Budgeted Cost for Work Scheduled (BCWS) is the sum of budgets for all work packages scheduled to be accomplished and is the measurement of work scheduled to be accomplished within a given time period. The Budgeted Cost for Work Performed (BCWP) is the sum of budgets for completed work accomplished. The Actual Cost of Work Performed (ACWP) is the cost incurred and recorded in accomplishing the work performed within a given time period. Each of these terms are precisely defined in Appendix D of the EVMIG (See DCAAP 7641.47). To ensure continued baseline integrity and to preclude distortion of performance measurement occasioned by unauthorized or arbitrary changes to the baseline and/or errors in the computation of the BCWS, the BCWP, or the ACWP, the auditor should periodically sample and test the accumulation of the BCWS, the BCWP, and the ACWP from the detail level to the contract summary level. The frequency and scope of such tests will be dictated by the adequacy of the procedures used and the result of prior audits. As a minimum, the following steps should be performed:

a. From the lowest levels, work packages, or cost accounts, the auditor should summarize the BCWS, the BCWP, and ACWP through the Work Breakdown Structure (WBS) to the contract level and

the Cost Performance Report. This should be done for both the current month and cumulative to date amounts.

b. The auditor should verify the computation of the BCWS and the BCWP.

c. Amounts should be summations from the lowest points of accumulation without intermediate allocations.

d. Indirect cost and labor rates applied should be the originally planned rates for work scheduled and work accomplished; also verify that acceptable rates are used for actual costs.

e. The system should distinguish between recurring and non-recurring costs.

f. Material costs should be recorded by the applied material costs concept, when applicable.

g. Deficiencies disclosed or errors noted should be discussed with contractor personnel for subsequent correction. Schedule subsequent surveillance audits to verify that required follow-up actions have been completed.

11-206 Contract Changes

Government-directed contract changes affect virtually all aspects of the contractor's internal planning and control system, including work authorizations, budgets, and schedules. Accordingly, the auditor should ensure that the procedures evaluated and accepted during the IBR/initial compliance audits are being followed by contractor personnel in effecting subsequent changes. Additionally, on a sample basis, contract changes should be audited to determine that:

a. The values of authorized changes have been incorporated into the baseline in a timely manner and effect given to the changes in estimates to complete, when necessary.

b. The estimated costs of undefinitized (authorized but unnegotiated) change orders have been incorporated into the baseline and, as required, adjustments made to the values of previous undefinitized changes subsequently negotiated.

c. Labor and burden rates used to plan effort required by changes represent rates expected to be experienced in the time frame in which the work is expected to be accomplished.

d. Continued integrity of the performance measurement baseline is necessary to ensure valid comparisons between work planned and work accomplished. Accordingly, changes to the baseline requiring government approval should not be made prior to government authorization. However, the very purpose of an EVMS is to provide visibility to the contractor and the government to enable both parties to consider reprogramming or redirection of effort and to effect trade-offs between cost, schedule, and/or technical performance, when necessary. Therefore, procedures should be established by the contractor whereby data concerning pending but unauthorized significant changes are made known to the government. Further, indications of such changes disclosed during the course of surveillance activities should be reported together with estimated costs, if available.

11-207 Cost Performance Report (CPR), Contractor Cost Data Report (CCDR), and Contract Funds Status Report (CFSR) Reconciliations

The purpose of reconciling external reports, such as the Cost Performance Report (CPR), Contractor Cost Data Report (CCDR), and the Contract Funds Status Report (CFSR) with each other and with contractor internal reports is to ensure that the information being reported is accurate and differences in data from one report or level to another are logical, consistent, and explainable. The contractor should make the necessary reconciliations. The auditor should perform the following steps, on a selective basis, to ensure that the reasons for differences between reports or levels of reports are valid, consistent, and acceptable.

a. The auditor should verify reconciliations between the CPR and the CFSR for contract target, actual cost, and estimated final cost.

b. The auditor should verify reconciliations between the CPR-reported data or its equivalent and the contractor's summary level data.

c. When applicable, the auditor should verify reconciliations of internal-reported

and CPR-reported data with CCDR-reported data for actual costs to date and estimated final cost. This should be accomplished for both data element and organization.

d. In those instances when reconciliations cannot be effected or when reasons for variances do not appear valid, the auditor should coordinate with the ACO and the CMO EVMS program monitor in recommending necessary procedural changes to ensure that subsequent valid reconciliations can be made.

11-207.1 Variance Analyses

The CPR provides for monthly disclosure of schedule and cost variances and contractor comments on significant problem areas, reasons for variances, their impact on the program, and corrective action taken or to be taken. The purpose of such variance analysis is to assess variances in terms of their contribution to cost growth and schedule slippage. The auditor's responsibilities on variances are to ensure that timely and responsible actions are taken to identify their causes and to minimize the impact of the variances on contract performance. Because of the effect of variances and contractor reactions thereto as they impact on planned downstream effort and projected estimates at completion, it is expected that considerable, frequent attention will be accorded this particular area in surveillance activities. Whereas the mechanical and procedural aspects of a EVMS can be time-phased based on prior experience, each month's system activities, as reflected in the CPR, may indicate:

(1) potential or real new problems,

(2) failure of the contractor to give prompt recognition to the effects of prior variances, or

(3) that actions taken with respect to previously disclosed variances were not responsive to actual needs.

Since schedule slippage and problems in technical performance also contribute to variances, the evaluation of variances and the contractor's proposed actions with respect thereto should be coordinated with the government program monitor and/or technical personnel. The following

steps should be followed in evaluating variances:

a. On a sampling basis, the auditor should select areas of significant cost variances as identified in the CPR and trace to the required action level.

b. The auditor should determine if the narrative descriptions of the variances are valid and adequate.

c. Causes and proposed remedies of the variances should be discussed with the contractor to determine if proposed actions will be responsive to the nature of the problem.

d. The auditor should evaluate estimated cost at contract completion to determine if the impact of any existing variances are reflected in the estimate to complete the contract.

e. As necessary, the auditor should establish follow-up to the contractor's proposed action(s).

11-207.2 Estimate to Complete

a. Detailed audit guidance for the evaluation of estimates for contract completion is in 14-205f. The frequency of evaluations of the latest revised estimates to complete a contract will depend upon the adequacy of the contractor's procedures, including internal audit procedures and the extent of contract changes which may, to some extent, give rise to revisions to the anticipated cost at completion. Because of the importance of estimated costs at completion, to both the contractor and the government, the auditor should perform a critical evaluation of the contractor's proposed amount. Coordination with technical personnel is necessary to properly evaluate the estimate to complete.

b. Contractors sometime report EACs to the government for billing and EVMS guidelines purposes which are different than those used for financial reporting purposes because of different risk assumptions and profit expectations. This is not a problem if the contractor can reconcile the differences. While it is necessary for auditors to compare EACs used by contractors for financial reporting purposes with those reported to the government, the provisions of DoD 5000.2-R and the EVMS guidelines do not require a

contractor to make such reconciliations and should not be used to gain access to financial statements. However, auditors should evaluate multiple EACs disclosed during EVMS guidelines audits. The contractor's inability to provide reconciliations may indicate performance to date and estimates of future conditions are not being accurately reflected in the contractor's EAC process which could be an EVMS deficiency. Auditors should typically pursue access in these instances under billing system/progress payment audits.

11-207.3 Indirect Expenses

The Cost Performance Report (CPR) or other reporting mechanism generally provides for reporting of indirect expenses as a line item. The contractor will analyze significant variances between the planned and actual rates and, when unfavorable variances exist, the contractor will indicate the cause and corrective action to minimize the effect on cost performance. The auditor should be aware of rates used to establish the performance measurement baseline as related to the rates being reported, and also of any anticipated changes expected to occur which affect the value of planned effort, such as volume fluctuation, terminations, and revisions to the rate structure. Surveillance reports should indicate the actions taken by the contractor with respect to unfavorable variances and also data on expected changes which may create significant variances in subsequent periods.

11-208 Surveillance of Subcontractors

It is the prime contractor's responsibility to accept and maintain surveillance of subcontractor EVMSs; however, there are unique situations when a subcontractor will be accepted and/or surveillance will be performed by a DoD component rather than a prime contractor. This may occur when:

(1) the subcontractor, for competitive reasons, refuses access to records to a prime contractor;

(2) the subcontractor is performing multiple contracts containing EVMS re-

porting requirements under more than one prime contractor; or

(3) the subcontractor may be functioning as a prime contractor on an accepted EVMS.

In these instances, the cognizant auditor at the subcontractor location will perform the necessary system surveillance by the procedures described herein. When the prime contractor has retained surveillance responsibility, the audit plan at the prime contractor location should include the following steps:

a. The prime contractor's program for surveillance of the subcontractor's system should be evaluated to determine depth, scope, and overall adequacy.

b. The results of the prime contractor's surveillance efforts, including follow up, should be evaluated to ensure that indicated deficiencies are subsequently corrected.

c. The results of the prime contractor's evaluation of subcontractor-reported data, including action taken by the prime on significant variances reported by the subcontractor should be evaluated. The auditor should verify that estimates to complete the subcontract are revised to reflect the impact of significant variances.

d. The timeliness of subcontract reporting and subsequent incorporation of related data in the prime contractor's monthly report should be evaluated.

e. The auditor should report the need for necessary assist audits on areas not adequately evaluated by the prime contractor and on deficiencies disclosed by the prime contractor's surveillance activities which have gone uncorrected over an extended period of time. In this connection, auditors at subcontractor locations should advise auditors at prime contractor locations of any deficiencies noted during the system audit which may have an impact on the continued acceptability and validity of the subcontractor's system and related output. Routing of requests for assist audits and submission of audit reports will be accomplished through ACO channels.

11-209 Audit Working Papers and Reports

11-209.1 Reporting Results of Audit --- Integrated Baseline Audits, Initial Compliance Audits, and Post Acceptance Audits for Cause

a. When the audit work related to an IBR initial compliance audit or a post acceptance audit for cause is finished, the auditor will discuss the findings and recommendations with the audit supervisor and furnish them to the team chief in such form and detail as required for the EVMS guidelines review team report. Any findings and recommendations will be provided to the team chief prior to completion of the in-plant effort of the EVMS guidelines review team, to enable the team chief to conduct the exit conference with the contractor. The FAO will retain the detailed working papers covering DCAA's part of the audit. Working papers supporting the auditor's conclusions regarding compliance or noncompliance with specific guidelines will be documented in all instances and will include a record of the conclusions which have been furnished to the team chief. Reported deficiencies should be identified to specific guidelines or the contractor's system description whenever possible. The auditor's report will be formally issued by the appropriate audit office as soon as possible after the EVMS guidelines review team exit conference with the contractor. The team chief will also be provided with any summary schedules and/or copies of working papers required for consolidation of statistical data or as additional supporting documentation for the EVMS guidelines audit file.

b. Provide Headquarters, ATTN: P, with a copy of each report which meets any of the following guidelines:

(1) Recommends the disapproval of a previously accepted EVMS.

(2) Discloses significant discrepancies in a contractor's EVMS.

(3) Discloses significant restrictions on audit caused by conditions such as denial of access to records.

**11-209.2 Reporting Results of Audit ---
Surveillance Audits**

a. Normally, the cognizant auditor will submit a formal report at the conclusion of surveillance audits. The report should be prepared in accordance with 10-1200 and provide clear statements of the scope of the audit and any deficiencies noted, together with recommendations for their correction. Comments should also be provided regarding the results of discussions with the contractor's representative on deficiencies disclosed. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the CMO EVMS monitor prior to issuance of the report. Systemic EVMS deficiencies should be highlighted in the report. Whenever possible, the auditor should relate any deficiencies to specific EVMS guidelines. The report should be addressed to the principal cognizant ACO. A copy of the report will be provided directly to the CMO EVMS monitor and the affected program office(s). A copy of each report meeting any of the guidelines stated in 11-209.1.b above will also be provided Headquarters, ATTN: P.

b. There may be instances where issuance of a formal audit report will not be necessary. Bearing in mind that EVMS surveillance is an ongoing process, there will be sporadic contact between project office personnel, ACO/monitor, and the auditor on questions or situations requiring only minimal effort. Oral advice or memorandums may suffice in these instances. Working papers will be annotated to indicate what was accomplished. In the event that the impact of findings is significant, however, a formal report will be issued.

c. When applicable, surveillance reports should include a reference to reports issued on the results of system audits (see 14-500) that had an impact on or were affected by the EVMS.

d. Deficiencies being reported in surveillance reports also need to be reported in proposal audit reports in an Appendix on Other Matters on proposals expected to result in contracts covered by DFARS clause 252.234-7001, Earned Value Management Systems, or DFARS clause

252.242-7005, Cost/Schedule Status Report.

e. When deficiencies are disclosed while performing audits of material management and accounting systems (MMAS), labor, other accounting systems, forward pricing rates, budgets, and billing systems, the auditor will assess whether the deficiencies are likely to have a material effect on the reliability of the contractor's EVMS and provide comments in the related report on the system or forward pricing rates. The auditor should immediately evaluate the impact of these deficiencies on the contractor's EVMS data for specific contracts and where material provide the details in EVMS surveillance reports (10-1200). Periodic EVMS surveillance audits (11-204) are still required.

f. Continued availability of information supporting earned values, incurred costs, and estimates to complete is necessary to perform proper surveillance of EVMS. In the event access to required contractor data is withheld or unduly restricted, follow the procedures in 1-500. When denial is continued, each surveillance report should include appropriate modification of the scope and opinion statements, with identification of the data being denied and its relationship to system surveillance requirements. If internal management budgets and forecast data are not made available during the surveillance audit, the auditor should qualify the audit report and should recommend that the system validation be withdrawn. When applicable, the CAC should establish uniformity in necessary report qualifications to ensure consistency within corporate structures when more than one corporate segment is subject to EVMS requirements.

**11-210 Cost/Schedule Control (C/SC)
Systems**

a. As prescribed in DFARS 242.1107-70(a), many government contracts contain the clause at DFARS 52.242-7005 requiring an approved C/SC system for performance measurement on selected acquisitions. The regulations promulgating C/SC systems require that related program budgets be an integral part of the contractor's internal management system to enable the con-

tractor to control costs properly. The adequacy and accuracy of C/SC system output are extremely important to the government. DCAAP 7641.92, C/SSR Joint Guide provides processes and procedures for the cost/schedule management of contracts containing DFARS 52.242-7005. DCAAP 7641.92 includes implementation and use of the Cost/Schedule Status Report (C/SSR) and the Cost Performance Report (CPR) when not associated with the use of the DoD Earned Value Management Systems Guidelines (EVMSG).

b. Two major purposes of C/SC systems are to provide continuing visibility of final costs to the government and to quickly identify deviations from planned objectives in order to decide effectively on trade-offs between cost, schedule, and technical aspects. In this regard, estimated cost to complete is of vital concern and should reflect the best information available to the contractor. It is the government's responsibility in its surveillance of the C/SC system to determine that recorded costs are properly reported and to evaluate the reasonableness of estimated costs to complete.

c. To increase the reliance that can be placed on such estimates, the government should evaluate master budgets and long-range plans (during contract duration), as well as the program budget. The government must know if the cost to complete, as indicated by the program budget, is reconcilable to master budgets

and other information used by management to control company operations. Accordingly, the auditor will perform the following steps.

(1) Determine that the program budgets required by C/SC systems are an integral part of the contractor's overall system for planning and controlling costs.

(2) Verify that the program budgets provide continuing visibility of interim and final costs to the government and that changes in plans are reflected promptly in new estimates to complete.

(3) Determine that the program budgets are used to identify significant deviations from planned objectives and quickly report these deviations to both contractor management and the government.

(4) During surveillance of C/SC systems, determine whether the recorded costs and the estimated cost to complete are reconcilable to master budgets and other information used by management to control company operations. This is particularly important for indirect cost projections because variance analysis of the operating budget is one of the techniques management should use to control indirect costs.

d. The impact of conditions disclosed during C/SC system audits should be considered when planning and performing other audits. For example, deficiencies in estimating costs at completion may significantly affect contractor forward pricing proposals and billing requests.

11-300 Section 3 --- Audit of Contractor Compliance with DoD Program Management Systems Reporting Requirements

11-301 Introduction

This section provides audit procedures and guidance for auditing contractor management control systems, and the related cost reports, which implement the requirements in DoD 5000.2-R. Audit effort required for the audit of the various contractor responsibilities under the regulation should be integrated with other system audits (such as audit of incurred costs, evaluation of proposals, and estimating system surveys, etc.).

11-302 Background

a. Over an extended period of time, the Office of the Secretary of Defense and the military departments have developed a variety of management systems for use in the acquisition process. These systems provide the government with a capability to obtain timely and valid cost, funding, schedule, and related management information for use in contract performance analysis and program control. In March 1996, DoD Directive 5000.1, and DoD 5000.2-R, "Mandatory Procedures for Major Defense Acquisition Programs (MDAPs) and Major Automated Information System (MAIS) Acquisition Programs", were issued replacing all previous DoD acquisition management policies and procedures. In addition, DoD accepted Industry Standard Guidelines for Earned Value Management (EVM) replaced the Cost/Schedule Control System Criteria (C/SCSC). In October 2000, DoD Directive 5000.1 was revised and DoD Instruction 5000.2, Operation of the Defense Acquisition System, was issued. In June 2001, DoD 5000.2-R was revised. DoD contract cost management reporting requirements are contained in DoD 5000.2-R, Subpart 7.15.7, "Contract Management Reports." Audit guidance relative to EVMS criteria is discussed in 11-200. DCAA audit effort under DoD 5000.2-R primarily involves the evaluation of contractor financial records to validate the accuracy and propriety of reported data.

b. The following standard cost management reports are prescribed in DoD 5000.2-R, Subpart 7.15.7. These reports are:

- (1) Contract Funds Status Reports (CFSRs),
- (2) Cost Performance Reports (CPRs),
- (3) Cost/Schedule Status Reports (C/SSRs), and
- (4) Contractor Cost Data Reports (CCDRs).

Audit guidance pertaining to these cost management reports is discussed in the ensuing paragraphs.

11-303 Contract Funds Status Report (CFSR)

11-303.1 Introduction

The objective of the CFSR is to provide information about contract funding requirements for specifically designated programs to assist the system manager in:

- (1) updating and forecasting contract fund requirements,
- (2) planning and decision making on changes in the fund requirements,
- (3) developing fund requirements and budget estimates in support of approved programs, and
- (4) determining funds in excess of contract needs and available for deobligation.

11-303.2 Application

a. The CFSR, DD Form 1586, is used to obtain funding data on contracts over 6 months in duration. No specific application thresholds are established; however, application to contracts of less than \$1.3 million (constant year 2000 dollars) is evaluated carefully to ensure that only the minimum information necessary for effective management control is required. Firm-fixed-price contracts are excluded from CFSR coverage unless unusual circumstances require specific funding visibility. CFSR may be applied to unpriced portions of firm-fixed-price contracts that individually or collectively are estimated by the government to be in excess of 20

percent of the initial contract value. The reports are prepared quarterly under normal circumstances and are submitted within 25 calendar days after the cut-off date or the number of days specified in the contract. Under unusual circumstances monthly reporting may be required.

b. In view of the comparatively low dollar threshold of contracts under which CFSR reports are required, the guidance furnished in 11-303.4 and 11-303.5, below, must be judiciously applied in order to avoid extensive audit involvement under comparatively small dollar value contracts.

11-303.3 Interrelationship with CAS

Cost Accounting Standard 401, "Consistency in Estimating, Accumulating and Reporting Costs," was established to (1) assure that cost accounting practices used by a contractor in estimating costs for proposals are consistent with those practices used in accumulating and reporting costs during contract performance and (2) provide a basis for comparing such costs. The auditor should ensure that data in budget and management reports required by the contract meet CAS 401 requirements (8-401).

11-303.4 Audit Objectives and Procedures

a. The CFSR report is an integral part of DoD's contract performance measurement system and the data reported is used for high-level management purposes; accordingly, CFSR submissions should be carefully and periodically audited.

b. The audit of a contract and the briefing of its provisions (see 3-200) will disclose whether the contract incorporates CFSR reporting requirements.

c. When specifically requested by the contracting officer, a survey will be performed prior to the award of a contract under which CFSR requirements are contemplated. The preaward survey will include an evaluation to determine if the contractor's accounting system and procedures are adequate and reliable for CFSR purposes, and will also consider the con-

tractor's procedures for accumulating and reporting total cumulative expenditures and for estimating contract completion costs. Audits of individual CFSR submissions will also be made at the specific request of the contracting officer.

d. Selective audits will be performed periodically to determine if satisfactory policies and procedures are being used in developing CFSR and other reported data and whether reported information is reliable. The frequency of such audits will be a matter of judgment based upon the results of the preaward survey and/or the auditor's experience with the reliability of CFSR data. However, audit of the adequacy of a contractor's CFSR data accumulation procedures, and the propriety of related reporting, shall be accomplished at least once a year at those contractor locations where the prices of CFSR-covered contracts aggregate \$50 million or more unless the requirement is waived by the regional audit manager.

e. The information in CFSRs should also be compared with like data which may have been presented by the contractor in other financial management reports for comparable periods, such as the C/SSRs and CPRs, to determine if they agree or are reconcilable. Inconsistencies or differences among reported data not adequately explained should be brought to the attention of the contracting officer.

f. The auditor should follow the guidance in 11-100 relative to "Limitation of Cost" and "Limitation on Payments" contract clauses, as appropriate. When it becomes evident that a loss is anticipated for a fixed-price contract, the auditor will ascertain whether the contractor is entitled to progress payments. If so, the auditor should make sure that the indicated rate of loss disclosed in the CFSR audit is applied as a reduction to any costs submitted by the contractor for purposes of computing its progress payment entitlement.

g. Audit of CFSR submissions will include evaluation of contractor compliance with the reporting due date provided for in the contract or as otherwise agreed to between the contractor and the contracting officer. Deficiencies in meeting required submission dates will be dis-

cussed with the contractor. Continued failure to meet submission dates should be reported in writing to the contracting officer together with recommendations required to correct the deficiencies. A copy of the report will be forwarded to Headquarters, ATTN: P.

h. The results of audits of the operations of major contractors made in accordance with 14-500 should also be considered in determining the scope of audit.

11-303.5 Reporting Results of Audit

a. An audit report will be prepared (1) on each preaward survey requested by the contracting officer, (2) in response to the request of the contracting officer for audits of individual CFSRs, (3) on each audit of CFSR data accumulation and reporting procedures when significant deficiencies are disclosed, and (4) whenever a procedural deficiency or major accounting change has a significant adverse effect on the accuracy of submitted CFSR data.

b. The preaward survey report should be prepared in accordance with 5-200. It will include the auditor's opinion on the adequacy of the contractor's accounting system and procedures to generate the type of data required by the CFSR.

c. Audit reports will:

(1) indicate the impact of deficiencies on the accuracy of the reported data,

(2) recommend corrective action to be taken by the contractor,

(3) state the contractor's reaction to the recommendation and any corrective action planned or initiated, and

(4) include the status of any previously reported deficiencies which the contractor has not satisfactorily corrected.

To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the ACO prior to issuance of the report.

d. Audit reports will be addressed to the activity requesting the audit with a copy to the ACO. Reports resulting from audits initiated by the auditor will be addressed to the ACO. The guidance provided in 10-1200 should be followed in the preparation of reports resulting from CFSR audits.

11-304 Cost Performance Report (CPR)

11-304.1 Introduction

The objective of the CPR is to provide data to government system managers which may be used by them to:

(1) evaluate contract performance,

(2) identify actual and potential problem areas having significant cost impact, and

(3) respond to requests for program status information on major weapon/support system acquisitions.

To permit this type of management control, the CPR requires, among other things,

- information on cost and schedule performance by work breakdown structure and functional cost categories,
- actual manpower utilization versus the budgeted plan, and
- narrative comments explaining major cost and schedule variances, as well as an identification of significant problems and action contemplated for their resolution.

11-304.2 Application

a. The CPR is required on all contracts which require compliance with the EVM guidelines of DoD 5000.2-R, Subpart 2.9.3.4. CPRs are not required on firm-fixed-price contracts unless unusual circumstances require cost and schedule visibility. However, it may be required on flexibly priced contracts, not subject to EVM guidelines, when the DoD component requires more data than available on the C/SSR.

b. In those instances where the CPR supports a contractual requirement for contractor compliance with EVM guidelines, the CPR data elements will reflect the contractor's implementation of DoD 5000.2-R. If compliance with the EVM guidelines is not contractually required, the data elements to be reported on the CPR will be as specified in the solicitation document or as subsequently negotiated.

c. The CPR will be submitted monthly unless otherwise provided for in the contract. Military department reports used to collect similar cost and schedule perform-

ance information from contractors are to be superseded when the CPR is made a contractual requirement.

11-304.3 Audit Objectives and Procedures

a. Because the CPR is an integral part of DoD's contract performance measurement system and the data reported is used for high-level management purposes, it is necessary that DCAA periodically and carefully audit CPR submissions.

b. The audit of a contract and the briefing of its provisions (see 3-200) will disclose whether the contract incorporates CPR reporting requirements. If so, the auditor will evaluate the adequacy and effectiveness of the policies and procedures established by the contractor for developing and reporting actual and projected costs.

c. The auditor will establish controls to assure the receipt of all CPR submissions.

d. An audit will be made of the contractor's initial CPR submission under each contract. Audits of subsequent CPR submissions will also be made at the request of the contracting officer and as provided in e. below.

e. Audit evaluation of the contractor's policies and procedures providing for the accumulation of data and CPR preparation shall be performed at least once a year. Various CPRs submitted under each of the contractor's eligible contracts shall be selectively tested during this evaluation, to assure the accuracy and propriety of report data. Audits will be made more frequently if the initial and/or subsequent evaluations disclose significant deficiencies; the frequency of such evaluations will depend upon the circumstances involved. The audit evaluation should consider the requirements of CAS 401. (See 8-401 with regard to consistency in reporting costs.)

f. Data reported in the CPRs should be compared with like information which may have been presented by the contractor in other financial management reports for comparable periods, such as the CFSRs and CCDRs, to determine if they agree or are reconcilable.

g. The CPR audit will include an evaluation of contractor compliance with the reporting due date provided for in the

contract or as otherwise agreed to between the contractor and the contracting officer. Deficiencies in meeting dates will be discussed with the contractor. Continued failure to meet submission dates should be reported in writing to the contracting officer together with recommendations required to correct the deficiencies. A copy of the report will be forwarded to Headquarters, ATTN: P.

11-304.4 Reporting Results of Audit

a. An audit report will be prepared using the format contained in 10-1200, on the contractor's initial CPR submission for each contract. It will state the auditor's opinion on the adequacy of the contractor's CPR policies, procedures, and internal controls and the accuracy of the reported cost data. An audit report will also be prepared in response to specific requests for audit by the contracting officer.

b. If subsequent audits of the contractor's CPR procedures made according to 11-304.3e. above disclose significant deficiencies, or the auditor is unable to reconcile specific data with like information on CFSRs or other management system reports for comparable periods, the audit reports will (1) indicate the impact of the deficiencies on the accuracy of the reported cost data, (2) specify the reports to which the deficiencies pertain, (3) recommend corrective action to be taken by the contractor, and (4) state the contractor's reaction to the recommendations and any corrective action planned or initiated. Audit reports will include the status of any previously reported deficiencies which have not been satisfactorily corrected. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the ACO prior to issuance of the report.

c. All audit reports will be submitted to the contract administration office. When significant deficiencies are disclosed, a copy of the report will be forwarded to Headquarters, ATTN: P.

d. It is not expected that the contracting officer will request an audit of each CPR submission; however, at those contractor locations where serious deficiencies continue, it may be necessary to issue periodic

audit reports indicating contractor progress in correcting such deficiencies.

11-305 Cost/Schedule Status Report (C/SSR)

11-305.1 Introduction

The objective of the C/SSR is to provide summarized cost and schedule performance status information on contracts over 12 months in duration when application of the Cost Performance Report (CPR) is not appropriate. The C/SSR requires (1) information on cost schedule performance by work breakdown structure and (2) narrative comments explaining major cost and schedule variances, as well as an identification of significant problems and action contemplated for their resolution.

11-305.2 Application

a. No specific application thresholds are established; however, application to contracts of less than \$6.3 million (constant year 2000 dollars) is evaluated carefully to ensure that only the minimum information necessary for effective management control is required. C/SSR is not required on firm-fixed-price contracts unless unusual circumstances require cost and schedule visibility. C/SSR is established as a contractual requirement as set forth in the Contract Data Requirements List, DD Form 1423, and Management System Summary List, DD Form 1660.

b. The C/SSR will be submitted in accordance with the terms specified in the contract but is not required more frequently than monthly.

11-305.3 Audit Objectives and Procedures

The audit objectives and procedures in 11-304.3 also apply to C/SSR.

11-305.4 Reporting Results of Audit

a. Audit reports pertaining to a contractor's initial submission will be prepared in accordance with the format in 10-1200. The report will state the auditor's opinion on the adequacy of the contractor's C/SSR policies, procedures, and internal controls and the

accuracy of the reported cost data. Audit reports will also be prepared only in response to specific requests for audit by the contracting officer, or when deficiencies are disclosed during DCAA-initiated audits.

b. If subsequent audits of the contractor's C/SSR procedures disclose significant deficiencies, or the auditor is unable to reconcile specific data with like information on CFSRs or other management system reports for comparable periods, the audit reports will (1) indicate the impact of the deficiencies on the accuracy of the reported cost data, (2) specify the reports to which the deficiencies pertain, (3) recommend corrective action to be taken by the contractor, and (4) state the contractor's reaction to the recommendations and any corrective action planned or initiated. Audit reports will include the status of any previously reported deficiencies which have not been satisfactorily corrected. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the ACO prior to issuance of the report.

c. All audit reports will be submitted to the contract administration office. When significant deficiencies are disclosed, a copy of the report will be forwarded to Headquarters, ATTN: P.

d. Contracting officer requests for audits of each C/SSR submission are not expected; however, at those contractor locations where serious deficiencies continue over a period of time, it may be necessary to issue periodic audit reports indicating contractor progress in correcting such deficiencies.

11-306 Contractor Cost Data Report (CCDR)

11-306.1 Introduction

The purpose of the CCDD, DD Form 1921, is to collect projected and actual cost data on selected contracts within acquisition programs, from contractors and government facilities, to assist DoD procuring activities in (1) preparing cost estimates for acquisition programs reviewed by the Defense Systems Acquisition Review Council (DSARC); (2) developing independent government cost estimates in support of

cost-effectiveness studies, budget/cost comparisons, and contract negotiations; and (3) tracking actual versus contractor negotiated costs.

11-306.2 CCDR Acquisition Program Categories

DoD 5000.2-R has divided CCDR procedures into two acquisition program categories. Category I applies to all major defense acquisition programs that are estimated by the Under Secretary of Defense (Acquisition and Technology) to require an eventual total research, development, test, and evaluation (RDT&E) expenditure of more than \$355 million or an eventual total procurement expenditure of more than \$2.135 billion in constant fiscal year 1996 dollars. Category II applies to selected contracts or to specific line items within category I. Generally, CCDRs are not required on contracts below \$2.4 million (FY 1996 dollars).

11-306.3 Category I Information Reporting Requirements

For Category I acquisition programs, the identification of prime contractors and subcontractors who are required to report is determined during the CCDR plan review process. However, mandatory reporting is required for all development contracts, contracts for first class items (such as lead ships, or low rate production) unless specifically waived by the Chair, OSD Cost Analysis Improvement Group (CAIG). Also, unless waived by the OSD CAIG, reporting is required on firm-fixed-price prime contracts or subcontracts when those contracts represent a major share of the research and development or production of a Category I acquisition program or component thereof.

11-306.4 Category II Information Reporting Requirements

For programs covered under Category II procedures, CCDR plans shall be audited and approved in time to be included in the request for proposal for the contract on which the category II procedure will be required.

11-306.5 CCDR Implementing Procedures

To implement CCDR, the procuring activity must prepare a CCDR plan showing the proposed collection of cost data by work breakdown structure for each program being reported, the required CCDR form, and the frequency with which reports are required. The plan normally includes other management system reporting requirements, such as Cost Performance Reports (CPR) and Contract Funds Status Reports (CFSR), to give an overview of all cost data being collected on the contract and the relationships between the reporting systems. The CCDR plan is subject to higher level audits.

11-306.6 CCDR Information Requirements Forms

a. CCDR forms from the 1921 series are the basis for the contractor's response to the Request for Proposal (RFP). Contractors will submit the information in the format required in the solicitation (for example, FAR 15.408, Table 15-2), supported by the CCDR forms when required by the procuring activity.

b. Cited below are four DD forms for CCDR. Normally all of them will be used for Category I contracts. For Category II reporting, normally only DD Forms 1921-1 and 1921-2 will be used; however, when financing for a Category II contract is substantial enough to require the application of a work breakdown structure, DD Form 1921 may be used at the discretion of the contracting DoD component.

(1) The Cost Data Summary Report (DD Form 1921) summarizes all contract activities and reports total costs against each of the work breakdown structure reporting elements specified in the contract. The contractor submits this report as a program estimate in response to a request for proposal at the time of contract award, and as the contract specifies. It provides summary level cost data cumulatively to date and estimated at completion with a breakout of recurring and nonrecurring costs.

(2) The Functional Cost-Hour Report (DD Form 1921-1) identifies comparable functional cost and labor-hour data; for

example, engineering, tooling, and manufacturing for the contract and/or selected reporting elements in the contract. This information is cumulative for both the reporting contractor and subcontract products and services. Category II contract reports also provide current-period functional labor-hour expenditures and data on plant-wide labor and indirect costs. A breakout is required for recurring and nonrecurring costs. These reports are also submitted as a program estimate in response to a request for proposal, as a contract estimate 45 days after contract award or signature of a letter contract, and as the contract specifies.

(3) The Progress Curve Report (DD Form 1921-2) provides a unit or an average unit cost of the unit or lot accepted during the reporting period. It also gives functional labor-hour and cost data on the average cost of units or lots accepted, the estimate for the next unit or lot, and the estimate to complete the contract. The contractor must submit the report initially 45 days after contract award or signature of a letter contract and thereafter as specified in the contract. Contracts which do not provide for deliverable end items or hardware do not require this report, nor do requests for proposals.

(4) The Plantwide Data Report (DD Form 1921-3) is a standardized overhead report intended to replace the various types of indirect cost data forms contracting offices previously used for major acquisitions. The contractor prepares the report on the basis of its estimating and accounting systems, although some data may have to be reclassified to ensure a common data base for estimating costs within DoD. The report is required for Category I contracts only and should contain:

(a) Detailed information on major government projects, including the number of units and the procuring activity, and direct cost data by function; for example, engineering and manufacturing. The same data are provided for remaining plant work segregated between other government and commercial work.

(b) Indirect cost data by function.

(c) Average actual and estimated labor rate data for the four quarters of the current calendar year, as an average for the past year, and as projected for the next two years.

11-306.7 Objectives of the Audit

The auditor is required to evaluate the effectiveness of the contractor's policies, procedures, and practices to produce data compatible with the objectives of CCDR and make selective tests of reported data.

11-306.8 Audit Procedures

a. If the contractor's CCDR system has not been audited, evaluate the contractor's proposed procedures for accumulating data and CCDR preparation to assure their compatibility with the accounting system and the reporting requirement in the RFP. Methods for auditing data in support of a price proposal should not be changed because of CCDR formats; however, the auditor should point out problems caused by system deficiencies to the contracting officer. Identifying and correcting deficiencies is critical at this point because the data, in the prescribed format, become the baseline for negotiation and 10 U.S.C. 2306a and 41 U.S.C. 422 purposes. Forms submitted at the time of contract award become the baseline for DoD data bank purposes and measuring contract performance. Failure to identify and correct major deficiencies would negate the purpose of CCDR by making comparison of data meaningless.

b. Evaluate the effectiveness of the contractor's system, policies, and procedures for accumulating data and preparing CCDRs at least once each year. In this evaluation various CCDRs submitted under each of the contractor's eligible contracts will be selectively tested, to assure that the reported data are accurate and conform to the requirements of DoD Regulation 5000.2-R. Particular attention should be given to the contractor's estimate at completion. The evaluation should assure that it is the "best estimate" without regard to established ceilings or contract price and that the contractor has properly considered variances between budget and actual costs in preparing the estimate. Audits will be performed more frequently if they disclose significant deficiencies.

c. As with most system audits, auditors should consider the results of other evaluations in determining the scope of audit. This will minimize work required to ac-

comply with the objectives of the CCDR audit.

d. Compare CCDR data with similar contractor information in other financial management reports such as Contract Fund Status and Cost Performance Reports for agreement or reconcilability.

e. The CCDR audit will include evaluating contractor compliance with report due dates in the contracts or established between the contractor and the contracting officer. Discuss deficiencies in meeting due dates with the contracting officer so that corrective action can be taken.

11-306.9 Reporting Results of Audit

a. Prepare a report according to 10-1200 covering the contractor's first CCDR submission which includes actual costs for each contract. The report will state the auditor's opinion on the adequacy of contractor CCDR policies, procedures, and internal controls and the accuracy of reported cost data. Also prepare reports in response to contracting officer's specific requests for audit.

b. If subsequent audits of contractor procedures disclose significant deficiencies or the contractor cannot reconcile specific data with similar information for comparable periods, the audit reports will:

(1) show the deficiencies' effect on the accuracy of the reported cost data,

(2) specify reports to which deficiencies pertain,

(3) recommend contractor corrective action, and

(4) state the contractor's reaction to the recommendations and any corrective action planned or initiated.

Audit reports will include the status of any previously reported deficiencies which have not been satisfactorily corrected. To ensure that all pertinent data have been considered, the auditor will discuss findings and recommendations with the contracting officer before the report is issued.

c. All audit reports will be submitted to the administrative contracting officer, with a copy to the designated DoD component official responsible for CCDR, as well as a copy to the Office of the Secretary of Defense Cost Analysis Improvement Group (CAIG) at the following address:

OSD, OD/Program Analysis and Evaluation Division
Cost Analysis Division
Room 2C310, The Pentagon
Washington, DC 20301-1800